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SUBJECT: INFLATION REACHES 12.1% IN FEBRUARY

REF: A. Cairo 282 B. Cairo 330

Summary

¶1. (U) Inflation surged to 12.1% year-on-year (y-on-y) in February, up from 10.5% y-o-y in January. Food prices led the rise, reflecting rising global food prices. Local analysts believe the Central Bank will raise interest rates again this month, but predict that greater exchange rate flexibility may also be needed to control inflation. The GOE increased its allocation for food subsidies, but bread prices continue to rise, caused by shortages of subsidized bread at public bakeries. Residents of the Nile Delta town of Mahalla told us that they were not enthusiastic about joining workers from the local textile mill in demonstrations over high prices, preferring instead to seek work overseas.

Inflation Surges

¶2. (U) Egypt's inflation rate surged to 12.1% y-o-y in February, up from 10.5% y-o-y in January, according to the GOE's Central Agency for Public Mobilization and Statistics. February's rate is the highest since April 2007, when inflation peaked at 12.6% y-o-y. Food, which constitutes 40% of Egypt's consumer basket, continued to drive inflation. Food prices rose 16.8% y-o-y in February, up from 16.2% y-o-y in January. Edible oil led the way, surging 39.8% y-o-y, from 26.4% y-o-y in January. Bread and grains followed, rising 26.5% y-o-y, though this was down from 34.9% y-o-y in January. According to a report by EFG-Hermes, Egypt's largest investment bank, the rise in edible oil and bread prices is mainly driven by high international prices for palm oil and wheat, which jumped 70% in 2007.

¶3. (U) The Central Bank's Monetary Policy Committee (MPC) will meet March 20, and local analysts are predicting an interest rate increase of about 75 basis points. The MPC raised rates 25 basis points at its last meeting in early February (ref A). Analysts are skeptical, however, that another interest rate hike will control Egypt's inflation, given weak monetary policy transmission mechanisms between the Central Bank and the rest of the financial system, and excess liquidity in banks. If rate hikes do not halt inflation, EFG-Hermes predicts the Central Bank may be forced to allow greater exchange rate flexibility, which would likely lead to lower import prices.

Bread Prices Rise Despite Subsidies

14. (U) The GOE continues to use subsidy spending to keep domestic food prices low. Parliament increased the allocation for food subsidies by LE 4.7 billion (\$840 million) in February (ref B), bring the total food subsidy bill for FY 2007/08 to LE 14.4 billion (\$2.5 billion). The official price for one piece of subsidized bread is still 5 piasters (\$.01), though recent press reports claim that the government is considering raising the subsidized price. Despite the subsidies, bread prices continue to rise, driven by shortages of the subsidized bread at public bakeries. Public bakeries produce limited amounts of subsidized bread, using only part of their government-allotted quota of subsidized flour and selling the rest on the black market. Buyers unable to buy subsidized bread at public bakeries - often after standing in line for several hours - are forced to turn to private bakeries, which charge up to 25 piasters/piece.

Unrest and Apathy in Mahalla

15. (U) We recently visited the main food market in the Nile delta town of Mahalla, scene of wildcat labor strikes in 2007 and demonstrations in January and February against rising prices. Prices in the market were roughly equivalent to those in Cairo's markets. Low-grade cooking oil was selling for LE 9.50 (\$1.72)/liter, up from the LE 8 (\$1.45), observed during our last visit to a Cairo market in mid-February. A kilo of pasta was LE 4 (\$1.72)/kilo, up from LE 3.5 (\$.63), lentils were LE 8 (\$1.45)/kilo, up from LE 7.20 (\$1.30), and beans were LE 7 (1.27)/kilo, up from LE 6.30 (\$1.14). Butchers told us the price of meat has held steady at LE 13.80 (\$2.50)/kilo since the major Muslim holiday Eid al Adha in December 2007.

16. (U) At a public bakery, we saw a familiar scene of approximately 20-30 people standing in gender-segregated lines, waiting to buy subsidized bread. Buyers told us the bakery sells a maximum of 20 pieces of bread per person at the subsidized rate. Fights over bread sometimes break out, according to one buyer, especially toward the bakery's closing time, usually 2-3 hours after opening. Despite the prospect of standing in line for hours and coming up empty-handed, he said he understood why bakeries sell their allotted bags of subsidized flour on the black market. "I would do the same," he said. The subsidized bread in Mahalla was of noticeably better quality than the bread we observed at public bakeries in Cairo.

17. (U) Many buyers in the Mahalla market told us they were aware of the recent protests over rising prices, but had not participated. Only workers at the textile mill are willing to demonstrate, they said. The workers are convinced the government is now afraid of them, and they can accomplish anything by demonstrating. The rest of the people in town, however, do not believe protesting will do any good, one poultry vendor told us. He cited government corruption as the most important problem in Egypt, worse than inflation. He was especially critical of privatization, saying it was increasing poverty and destroying the middle class. Several of the people we spoke to said they were planning to seek work abroad, or had family members who were planning to do so. Libya was most often cited as the destination.
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